ENT-16 ALLOW HAYING OR GRAZING ON LAND IN ANNUAL SET-ASIDES AND IN THE LONG-TERM CONSERVATION RESERVE PROGRAM

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	80	92	89	100	91	452
Outlays	80	92	89	100	91	452

The Department of Agriculture usually requires participants in the support programs for wheat, feed grains, cotton, and rice to idle a portion of their land. Farmers receive no direct compensation for this but do get payments and other benefits based on production on the remainder of their land. Moreover, under provisions of the support programs, producers may voluntarily idle additional acreage and maintain a substantial portion of their program benefits. The idled land could be grazed or used to produce hay, which would increase the income of participating farmers. Current law, however, restricts such uses. The amount of land idled in the annual programs varies. During crop year 1994, about 13 million acres were idled. During crop year 1995, the Congressional Budget Office expects farmers to idle about 17 million acres.

The federal government also normally prohibits haying and grazing on land in the long-term Conservation Reserve Program. Participants in this program receive annual rental payments in exchange for agreeing to idle their land and maintain a protective vegetative cover. About 36 million acres are now in the conservation reserve. The Secretary of Agriculture can make exceptions to the haying and grazing prohibitions on conservation reserve land and that idled in the annual programs when weather or market conditions warrant.

This option would allow farmers to use some of this idled land for haying or grazing in exchange for a fee or a reduction in other government payments. The per-acre charge would be set according to local market rental rates for haying or grazing. Federal outlays would thus be reduced by an estimated $452 million over the 1996-2000 period. Savings would come from two sources: first, from the receipts from (or reduced payments to) farmers who want to hay or graze their land; second, from a reduction in costs of the price and income support programs for corn and other feed grains. The expansion of haying and grazing would cause a small decrease in the demand for corn and other feed grains. That would result in a slightly higher requirement in the Acreage Reduction Program, thereby reducing program outlays.

Proponents of allowing haying and grazing argue that a properly run program would allow farmers to use U.S. agricultural resources more efficiently with little reduction in the environmental benefits of current programs. (Land that is especially fragile environmentally would not be eligible for haying and grazing in this option.) In the past, many farmers, particularly in the southern Great Plains, have argued that grazing on land idled in the annual wheat program is an important source of feed. They also claim that it allows a more orderly marketing of cattle because this forage becomes available in the spring.

Some farmers and ranchers could take advantage of the opportunity to graze cattle on the otherwise unused land. These include livestock operators in the Southern and Northern Plains. About one-half of Conservation Reserve Program enrollees in these areas, for example, now have livestock facilities. Some of these operators could expand their enterprises, although lack of water and questionable forage quality might limit growth in some areas. Land could also be grazed in portions of the western Corn Belt, where water availability is less of a problem. Farmers who have the opportunity, facilities,

and expertise to establish or expand herds in these areas could benefit from allowing grazing. Farmers who can produce and market hay could also benefit.

Opponents argue that such a change would seriously endanger environmental benefits, particularly those derived from the Conservation Reserve Program. Grazing or haying could reduce the density of the protective cover crop and increase the possibility of environmental damage. Allowing haying and grazing could also greatly reduce the wild animal habitat protected by environmental programs.

Some farmers and farm groups would also object to this option. Commercial hay producers would face new competition. Producers of feed grains would lose some of their market as more forage became available. Livestock producers--other than those directly benefiting--might see a reduction in prices.

ENT-17 INCREASE FCC USER FEES

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	72	75	78	81	84	390

Increasing the level of fees charged by the Federal Communications Commission to holders of FCC licenses could increase receipts by $72 million in 1996 and by $390 million from 1996 through 2000. The Congress passed legislation in the Omnibus Budget Reconciliation Act of 1993 that established new fees for certain types of licenses and increased fees for others. These increases raised approximately $60 million in 1994 and are expected to raise $95 million in 1995. The fees, however, are earmarked for specific regulatory costs and do not cover all regulatory activities or agency overhead.

People who favor increasing licensing fees argue that the fees would cover the full cost of the services that the FCC provides to license holders. These services include regulation, enforcement, rulemaking, and international and informational activities. A recent legislative proposal would set the level of fees on the basis of the equivalent of full-time employees rendering service. The level would be adjusted for such factors as coverage of license holders' service areas and whether a license provides for shared or exclusive use. The level of fees provided in this estimate would be sufficient to cover the inflation-adjusted cost of FCC activities. Fees would be set lower if the FCC was restricted to the level of its 1995 funding.

People who argue against increasing FCC fees hold that such increases would drive marginal operators out of business. Low-power AM radio stations, for example, often maintain very small profit margins. A significant increase in the license fee of such a small operator could be sufficient to force the station to close. This difficulty could be overcome by linking fee increases to station coverage area or broadcast power. Moreover, this problem is less significant to license holders outside the broadcasting industry.

ENT-18 CHARGE A USER FEE ON COMMODITY FUTURES AND OPTIONS CONTRACT TRANSACTIONS

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	58	83	91	100	110	442

The Commodity Futures Trading Commission (CFTC) administers the amended Commodity Exchange Act of 1936. The purpose of the CFTC is to allow markets to operate more efficiently by ensuring the integrity of futures markets and protecting participants against abusive and fraudulent trade practices. A fee on transactions overseen by the CFTC could cover the agency's costs of operation. Such a fee would be similar to one now imposed on securities exchanges to cover the cost of the Securities and Exchange Commission (SEC).

The Administration's budget for 1994 proposed a transactions fee, set at 14 cents per "round turn transaction." Although this idea was dropped from the 1995 budget proposal, such a fee, if imposed in 1996, could generate revenues of $442 million over the 1996-2000 period, which should be sufficient to cover the CFTC's operating expenses during that period. As proposed, the legislation to establish the fee would require the exchanges to remit it four times a year, based on trading volume during the previous quarter. The CFTC would collect the fee and deposit it as an offsetting receipt to the general fund of the Treasury. A similar fee, set at 10 cents per round turn transaction, has been proposed in the Administration's 1996 budget.

The main arguments in favor of the fee are based on the principle that users of government services should pay for those services. Participants in transactions that the CFTC regulates are seen as the primary beneficiaries of the agency's operations and therefore users who should pay a fee. Furthermore, the principle of charging such a fee has already been established by the SEC. Considerations of equity and fairness suggest that not charging a comparable fee to support CFTC operations could give futures traders an unfair advantage over securities traders.

Those who argue against the fee say that such charges tend to generate evasion on the part of people who would be subject to them. Users might try to avoid fees by limiting or shifting transactions to activities that are exempt from charges, which could conceivably cause market participants to desert U.S. exchanges for foreign ones. The effect of such actions could substantially lower the revenue from the fee and, of more concern, lower the benefits that futures transactions provide to the economy.

ENT-19 ELIMINATE THE FLOOD INSURANCE SUBSIDY ON PRE-FIRM STRUCTURES

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	361	378	396	414	433	1,982

The National Flood Insurance Program (NFIP) offers insurance at heavily subsidized rates for buildings constructed before January 1, 1975, or the completion of a participating community's "Flood Insurance Rate Map" (FIRM). Owners of post-FIRM construction pay actuarial rates for their insurance. Currently, 18 percent of total flood insurance coverage is subsidized. If all of the subsidized policyholders maintained their coverage at the higher rates, eliminating the subsidy would produce five-year receipts on the order of $2.6 billion. Because many policyholders would be likely to drop their coverage under this option, however, the Congressional Budget Office (CBO) estimates that new receipts would total about $2 billion over the next five years.

The Federal Emergency Management Agency (FEMA), which administers the flood insurance program, reported in 1994 that 41 percent of policyholders were paying subsidized rates for some or all of their coverage. The program subsidizes only the first $45,000 of coverage for a single-family or two- to four-family dwelling, and the first $130,000 of a larger residential, nonresidential, or small business building; various levels of additional coverage are available at actuarially neutral rates. Coverage in the subsidized tier is currently priced at about one-third of its actuarial value. The program also offers insurance for building contents; again, policyholders in pre-FIRM buildings pay subsidized prices for a first tier of coverage.

Some subsidized NFIP policyholders purchased their coverage voluntarily, but others did so because of a statutory requirement prohibiting federally insured mortgage lenders from making loans on uninsured properties in "special flood hazard" areas. Despite the subsidies and mandatory purchase requirement, participation remains low. The report of the Interagency Floodplain Management Review Committee estimated that only 20 percent of structures in the nine states of the 1993 Midwest floodplain carried insurance, reflecting both low rates of purchase for properties not subject to the mandatory requirement (which include an estimated one-half of owner-occupied homes) and the apparent unwillingness or inability of many lenders to enforce the mandatory requirement. The Congress included measures to increase compliance with the mandatory requirement and otherwise boost NFIP participation in the National Flood Insurance Reform Act of 1994. These provisions can be expected to reduce the percentage of current policyholders who would drop their coverage if the subsidies were eliminated, but CBO estimates that about 25 percent would do so nonetheless.

Proponents of eliminating the subsidy argue that actuarially correct prices would make all property owners in flood-prone areas pay their fair share for insurance protection, and would give them the economic incentives to relocate or take preventive measures.

One counterargument asserts that the subsidy should be maintained as part of an effort to increase the low rates of participation by property owners who are not subject to the mandatory purchase requirement. A second argument is that people who built or purchased property before FIRM documented the extent of the flood hazards should not face the same costs as those who made decisions after such information became available. Defenders of the current rates also question the accuracy of FEMA's actuarial tables; although the prices cover only one-third of estimated average costs over the long run, based on FEMA's mapping exercises, they represent 92 per-

cent of average losses incurred in the program. Finally, defenders argue that some of the projected benefit to the Treasury will be offset by increased spending by FEMA and the Small Business Administration on disaster grants and loans to people who drop or fail to purchase insurance coverage at the higher rates.

ENT-23 IMPOSE USER FEES ON THE INLAND WATERWAY SYSTEM

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	337	493	524	543	563	2,460

The Congressional Budget Office estimates that the Congress annually appropriates about $500 million for the nation's system of inland waterways. Of that total, about $230 million is for operation and maintenance (O&M) and about $260 million is for construction. Current law allows up to 50 percent of inland waterway construction to be funded by revenues from the inland waterway fuel tax, a levy on the fuel consumed by barges using most segments of the inland waterway system. Revenues from the tax currently fund about 20 percent of federal outlays for inland waterway construction. All O&M expenditures are paid by general tax revenues.

Imposing user fees high enough to recover fully both O&M and construction outlays for inland waterways would reduce the federal deficit by $337 million in 1996 and $2.5 billion during the 1996-2000 period. The receipts could be considered tax revenues, offsetting receipts, or offsetting collections, depending on the form of the implementing legislation. These estimates do not take into account any resulting reductions in income tax revenues.

The advantage of this option is the beneficial effect of user fees on efficiency. Reducing subsidies to water transportation should improve resource allocation by inducing shippers to choose the most efficient transportation route, rather than the most heavily subsidized one. Moreover, user fees would encourage more efficient use of existing waterways, reducing the need for new construction to alleviate congestion. Finally, user fees send market signals that identify the additional projects likely to provide the greatest net benefits to society.

The effects of user fees on efficiency would depend in large measure on whether the fees were set at the same rate for all waterways or according to the cost of each segment. Since costs vary dramatically among the segments, systemwide fees would offer weaker incentives for cost-effective spending. In 1989, for example, O&M costs on the inland waterways ranged from less than 50 cents per 1,000 ton-miles on the lower Mississippi River (between the Ohio River and Baton Rouge) to about $140 per 1,000 ton-miles on the Allegheny River. A systemwide fee of $1.75 per 1,000 ton-miles would recover all O&M outlays but would do little to ration use of the system. Fees set for specific segments, by contrast, could cause users to abandon some segments of the waterways.

One argument in favor of federal subsidies is that they may promote regional economic development. Assessing user fees would limit this promotional tool. Reducing inland waterway subsidies would also lower the income of barge operators and grain producers in some regions, but these losses would be small in the context of overall regional economies.

ENT-24 INCREASE USER FEES FOR GENERAL AVIATION

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	14	14	14	14	14	70

The Federal Aviation Administration (FAA) estimates that general aviation (private and corporate aircraft) accounts for 26 percent of the FAA's costs but only 2 percent of revenues from users of the aviation system. General aviation cost the system $2.1 billion in 1992 but generated revenues of only $157 million, a cost recovery rate of 7 percent. By contrast, commercial air carriers (or their passengers) pay more in taxes than their share of the costs, according to FAA estimates.

Currently, the FAA charges a $5 aircraft registration fee for general aviation. The fee is assessed only once, unless certain events--such as a change of ownership--trigger a need for reregistration. The current fee brings in about $200,000 annually. A yearly registration fee of $100 would produce receipts of $14 million a year and $70 million over five years; however, collection costs would be about $2 million a year, and the FAA might require additional appropriations to cover those costs. The receipts could be considered tax revenues, offsetting receipts, or offsetting collections, depending on the form of the implementing legislation. These estimates do not take into account any resulting reductions in income tax revenues.

Several arguments could be marshalled against this option. For one, the Drug Enforcement Assistance Act of 1988 authorizes the FAA to impose registration fees of up to $25--as long as they do not raise more in collections than the FAA's cost of administering the registration program. Setting higher fees would require additional legislation. In addition, increasing the registration fee to $100 annually might severely burden some aircraft owners, although that effect could be mitigated by scaling registration fees according to the size or value of the aircraft. In comparison with registration fees for automobiles in most states, however, a $100 fee to register an aircraft is not out of line.

But even if the FAA raised its registration fee to $100, the agency estimates that general aviation still would not be paying its share of costs. In order to narrow the gap, additional charges or taxes that varied with the amount of use of the FAA's services could also be imposed.

ENT-20 BROADEN AND EXTEND THE FCC'S AUTHORITY TO USE AUCTIONS TO ASSIGN LICENSES TO USE THE RADIO SPECTRUM

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	0	600	2,300	2,700	2,800	8,400

The Omnibus Budget Reconciliation Act of 1993 granted the Federal Communications Commission (FCC) authority to auction new licenses to use the radio spectrum. The authority, however, was limited to a five-year period ending on September 30, 1998, and did not extend to many classes of new licenses. The law excluded licenses issued to profit-making businesses that did not charge a subscription fee for telecommunications services. Most prominent among those excluded were licenses allowing the permit holder to offer broadcast television and radio supported by advertising. Also exempted were licenses permitting the holders to use the spectrum for such private networks as intracorporate wireless communications systems. Exemptions also included permits for intermediary links in the delivery of communications service, such as frequencies used for microwave relays by long-distance telephone companies. In addition, the law did not explicitly permit the FCC to auction other valuable rights that it allocates, specifically, telephone dial codes and commercially attractive call letters for radio and television stations.

Extending the FCC's authority to auction licenses beyond 1998 and broadening the commission's auction authority to include any license sought by a private business would increase receipts by $8.4 billion from 1996 through 2000. Under this option, however, the commission would continue to award licenses to private businesses by comparative hearing when there were not mutually exclusive applications for a band of frequencies. The estimate of five-year receipts includes those that might be gained by auctioning licenses for advanced television (ATV). The FCC has conducted four successful auctions raising more than $7 billion since it was granted the authority to auction licenses. Just how much this option would add to current-law receipts, however, is uncertain. Both telecommunications markets and technologies are changing rapidly and at times unpredictably. The market for licenses used for a variety of private purposes is untested. Moreover, the technical attributes and regulatory limitations carried by the licenses will not be known until the commission allocates frequencies for specific uses. That is particularly true in the case of advanced television, for which digital technology permits an array of options for picture and sound quality. The commission's future actions will have a significant effect on the value of those licenses. The most important decisions will be those that set the technical standard for ATV and determine whether the license holders will be permitted to provide services other than television with the frequencies covered by the license.

The case for extending and broadening the FCC's authority to auction the spectrum and to sell other valuable rights under its regulatory umbrella begins with recognition that the commission has successfully used the auction authority granted to it by current law. The process has gone smoothly, the public is receiving a share of the economic value of the airwaves, and licenses are being awarded promptly to the parties that value them most. Critics of the initial auction statute predicted a very different outcome. More important, advocates of broadening the FCC's auction authority argue that current law draws a false distinction in treating the frequencies used to produce one private good or service in another way than those used to produce a different private good or service. From this point of view the radio spectrum is a scarce resource. The cost to society of using frequencies in one way translates as benefits that might have been gained by using them in another way. That cost is not changed by the fact that a private network or

intermediary use is once-removed from the ultimate consumer of a good or service, or that subscribers do not pay directly for broadcast television. The market provided by an auction is a reasonable way not only to discover which users most value licenses for a specific use, but also to reveal whether the spectrum is being allocated to the most highly valued use from society's point of view. The case for auctioning other valuable rights allocated by the commission is essentially the same as the most basic arguments for auctioning spectrum licenses, namely, that auctions will assure a prompt, fair, and relatively inexpensive assignment of the right in question to the party who values it most.

The case against the option emphasizes a go-slow approach. Early auctions have been successful. Provisions of the law that allow the commission to encourage small businesses and those that are owned by minorities and women have been challenged. Critics might argue that broadening the law to include private networks and intermediary links will increase the cost to businesses seeking to innovate in these areas, thus discouraging the development of new telecommunications technologies and applications. Some people who argue against auctioning ATV licenses hold that the right to use the spectrum carries with it public responsibilities--for example, the equal access rules and those governing the prices charged for political advertising--that impose a cost on the license holder. The contention that broadcasters should receive license rights in exchange for meeting a public interest standard is not, however, recognized in the law. Moreover, all licenses to use the spectrum carry with them a public interest obligation regardless of how they are granted. Participants in an auction will bid less if they decide this obligation imposes a cost on them.

A more specific objection to auctioning ATV licenses holds that the move from the old standard to a new one is merely a channel upgrade and should be seen as a continuance of current license rights (for which many license holders have paid substantial amounts of money in purchasing television stations from their original owners) rather than a new license. In addition, advocates of the current plan hold that it represents a unique approach to the problems of freeing up the spectrum that is allocated to broadcasting under the prevailing standards, rapidly providing consumers with the benefits of improved television and smoothing the transition from old television sets to new ones for both producers and consumers.

The option considered is only one that would increase receipts collected by the FCC above the level anticipated under current law. Alternatively, the Congress could impose an annual fee on the holders of licenses who did not obtain them at auction, or auction all of those licenses not originally assigned by auction at the time of their renewal. Other extensions of the FCC's authority to auction that are not included in this option are those allowing license holders to pay for the right to use their spectrum assignments more flexibly, and allowing the commission to auction off blocks of spectrum without specifying a use.

ENT-21 ESTABLISH CHARGES FOR AIRPORT TAKEOFF AND LANDING SLOTS

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	500	500	500	500	500	2,500

The Federal Aviation Administration (FAA) has established capacity controls at four airports: Kennedy International and La Guardia in New York; O'Hare International in Chicago; and Washington National in the District of Columbia. This proposal would charge annual fees for takeoff and landing rights at those airports.

Takeoff and landing slots were instituted in 1968 to control capacity and were allocated without charge by the FAA. A total of about 3,400 air carrier slots exist, with an additional 1,400 commuter and general aviation slots at the four FAA-controlled airports. Airlines are currently allowed to buy and sell slots among themselves, with the understanding that the FAA retains ultimate control and can withdraw the slots or otherwise change the rules on their use at any time. These slots have value because the demand for flights at times exceeds the capacity of the airports and the air traffic control system.

Estimating the revenue from slot charges is difficult. Airlines generally have not reported the prices they have paid for slots, and even when the value of a transaction is available, the slot value is unclear because slot sales often include other items of value, such as gates. In addition, slot values vary by airport, time of day, season, and other factors. Because the FAA reserves the right to withdraw and add slots and change the rules affecting their use, airlines that buy slots from other carriers must factor in uncertainty when deciding how much a slot is worth. The amount of revenue that could be obtained from annual charges would depend on similar factors, including the length of the lease. For these reasons, the Congressional Budget Office's estimates are somewhat equivocal. Revenues are estimated to be about $500 million annually and $2.5 billion over the 1996-2000 period. But they could be higher or lower depending on the structure of the leasing arrangements --such as length, whether slots could be subleased, and usage requirements--as well as market conditions affecting the airline industry.

The main argument in favor of establishing charges for slots is that since the slots reflect the right to use scarce public airspace, airports, and air traffic control capacity, private firms and individuals should not receive all the benefits that result from this scarcity. Instead, they should share it with the public owners of the rights. Further, the charges would serve as incentives to put these scarce resources to their best use.

The main argument against this proposal is that the scarcity of slots at the four airports arises principally from a lack of land and runway space; the fees are not intended to provide increased capacity. Further, if the current prices paid by airlines in the private sale of slots already accurately reflect their value, this proposal might not produce a better allocation of these scarce resources; the result would be only a redistribution of the benefits from their use between the private and public sectors.

ENT-22 ESTABLISH USER FEES FOR AIR TRAFFIC CONTROL SERVICES

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	725	1,500	1,550	1,650	1,750	7,175

The Federal Aviation Administration (FAA) manages the air traffic control (ATC) system, which serves commercial air carriers, military planes, and such smaller users as air taxis and private planes. Services provided include air traffic control towers that assist planes in takeoffs and landings, air route traffic control centers that guide planes through the nation's airspace, and flight service stations that assist smaller users. The FAA has more than 17,000 air traffic controllers as well as sophisticated software to perform these tasks. The total cost of operating, maintaining, and upgrading the ATC system was about $6.2 billion in 1994.

Currently, one-half of FAA operations are financed through annual appropriations from the general fund, whereas revenues from aviation excise taxes are used for a variety of purposes, such as facilities and equipment, research, engineering and development, and such non-ATC activities as airport improvement.

Over the past year, several proposals have been advanced for reorganizing the FAA and spinning off its air traffic control functions to a private or quasi-public corporation. Such an entity would have to charge users for its services. If air traffic control remains within the FAA, the FAA could impose user fees to cover a larger portion of ATC costs than the excise taxes cover.

If users paid the marginal costs that the ATC system incurs on their behalf, the deficit would be reduced by about $725 million in 1996 and $7.2 billion over the 1996-2000 period. This assumes that the new charges would be levied in the middle of fiscal year 1996.

Users would be charged according to the number of facilities they used on a flight and the marginal costs of their use at each facility. The various classes of users would be affected differently. Smaller users, such as general aviation users, would experience comparatively greater increases in the cost of flying than larger users, such as commercial airlines.

Levying efficient fees presumably would oblige users to moderate their demands. Small users who are required to pay these costs would cut back on their consumption of ATC services, freeing controllers for other tasks and increasing the overall capacity of the system. An additional benefit of efficient fees is that, on the basis of user response, planners can judge how much new capacity is needed and where it should be located.

The main argument against this option is that it would raise the cost of ATC services. For commercial air carriers, this could contribute to their already difficult financial circumstances. For general aviation, it also could cause a decline in the demand for small aircraft produced in the United States.

ENT-25 REDUCE SUBSIDIES FOR STUDENT LOANS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Raise the Loan Origination Fee						
Outlays	275	405	420	430	450	1,980
Raise Interest Rates After the Six-Month Grace Period						
Outlays	340	530	585	630	665	2,750
Charge All Borrowers Interest While They Are Attending School						
Outlays	1,620	2,490	2,645	2,770	2,900	12,425
Charge All Borrowers Interest During the Six-Month Grace Period						
Outlays	330	510	545	575	610	2,570

Federal student loan programs afford postsecondary students and their parents the opportunity to borrow funds to attend school. The Higher Education Amendments of 1992 created a "subsidized" program for students defined as having financial need and an "unsubsidized" program for students from families with greater financial resources and for parents of students. In the subsidized program, the federal government incurs interest costs on the loans while the students are in school and during a six-month grace period after they leave. In the unsubsidized program, borrowers are responsible for the interest costs, although for students, payments can be made after they leave school. The government recoups part of the cost of these programs by collecting between 3 percent and 4 percent of the face value of each loan as an origination fee.

Borrowers benefit from both the subsidized and unsubsidized programs because the interest rate they are charged is tied to the cost of borrowing by the federal government. Although the government provides no budgeted subsidy in allowing borrowers access to funds at this low rate, the rate is considerably lower than that most borrowers would be charged in the private credit market. Nonetheless, the economic subsidy is larger in the "subsidized" program because interest is not charged until six months after the students leave school, whereas it begins to accrue immediately in the "unsubsidized" programs.

Federal costs could be reduced by increasing the loan origination fee charged to borrowers or by increasing the interest charged to borrowers on new loans. Interest charges could be raised by increasing the interest rate charged after students leave school, or by requiring all borrowers to accrue interest while students are in school or in the six-month grace period after they leave.

Raise the Loan Origination Fee to 5 Percent. Raising the loan origination fee to 5 percent (the level before the Omnibus Budget Reconciliation Act of 1993) would reduce federal subsidies by a total of $2 billion during the next five years. It would, however, give lower subsidies to all borrowers, including those with the fewest financial resources. An alternative, which would exempt many lower-income borrowers, would be to raise the fee only in the unsubsidized program. That version would, however, limit the savings to $820 million over the 1996-2000 period.

Raise Interest Rates After the Six-Month Grace Period. Federal subsidies could also be reduced by raising the interest rate and interest rate cap on all new variable-rate loans by 0.5 percentage points after the six-month grace period. For guaranteed loans, lenders would remit a fee to the federal government for these payments. This option would reduce federal spending by $2.7 billion during the 1996-2000 period.

An advantage of this option is that it would raise the cost of the program to borrowers after they left school, when they could better afford it. It would also lower federal costs significantly and continue to provide economic subsidies to borrowers in the subsidized program. The larger payments that would result from this change might, however, cause some students (especially needy students) to limit their choices to lower-priced institutions or possibly not to attend school. (Reflecting the available evidence, however, these estimates assume that all borrowers would continue to attend postsecondary schools and would continue to borrow the same amounts).

As with raising the loan origination fee, this option could be applied only to borrowers in the unsubsidized loan program. Doing so would generally limit the effect of the change to students from families with greater financial resources and to parents, but it would also lower the savings to $1.2 billion between 1996 and 2000.

Charge All Borrowers Interest While They Are Attending School or During the Six-Month Grace Period. Another option would be to require all borrowers in the subsidized program to accrue interest from the time they borrow, as is now the case in the unsubsidized program. In effect, doing so would eliminate the difference between subsidized and unsubsidized loans. Charging interest on all new loans while borrowers were in school, but deferring actual payments until after they left, would reduce federal outlays by $12.4 billion between 1996 and 2000.

A variation of this option that would reduce but not eliminate the subsidy given to lower-income borrowers would require all borrowers to begin accruing interest on their loans immediately after leaving school, thereby eliminating the current six-month grace period for subsidized borrowers. Under this option, borrowers would continue to be allowed a period of six months before the first payment was due. That approach would save about $2.6 billion over the 1996-2000 period.

These measures would not cause cash flow problems for students while they were in school because they would be allowed to defer interest payments during that period. Since the added costs would generally occur only after leaving school--when borrowers would be better able to afford them--most students would still be able to continue their education. By concentrating the reductions on the subsidized loan program, however, these options would have the greatest impact on lower-income borrowers.

ENT-26 REDUCE STAFFORD LOAN SPENDING BY INCLUDING HOME EQUITY IN THE DETERMINATION OF FINANCIAL NEED AND MODIFYING THE SIMPLIFIED NEEDS TEST

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Outlays	90	130	130	130	130	610

The Higher Education Act of 1992 eliminated house and farm assets from consideration in determining a family's ability to pay for postsecondary education, thereby making it easier for many students to obtain Stafford loans. The Higher Education Act specifies formulas to calculate a family's need for Stafford loans. The amount a family is expected to contribute is determined by what is essentially a progressive tax formula. In effect, need analysis "taxes" family incomes and assets above amounts assumed to be required for a basic standard of living. The definition of assets excludes house and farm equity for all families, and all assets for applicants with income below $50,000.

Under this option, house and farm equity would be included in the calculation of a family's need for financial aid for postsecondary education. In addition, the threshold under which most families are not asked to report their assets would also be lowered to its previous level of $15,000. House and farm equity would be "taxed" at rates up to roughly 5.6 percent after a deduction for allowable assets.

Outlays could be reduced by about $610 million during the 1996-2000 period by including house and farm equity and modifying the simplified needs test. There could also be associated savings in the Pell Grant program, a discretionary program that provides grants to low-income students. Outlays in that program could be reduced from the 1995 funding level adjusted for inflation by about $25 million in 1996.

Families whose house appreciated during the 1980s are now financially better off than they would have been if they had not owned a house then. Moreover, not counting this equity gives families who own a house an advantage over those who do not. There is concern, however, that because increases in incomes have not always kept pace with increases in housing prices, some families might have difficulty repaying their mortgage if they borrow against the equity in their house to finance their children's education. In addition, having to value their home and other assets would complicate the application process for many families.